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2/1/83

Financial Markets

Irving Trust

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Friday (Noon) Jan. 28, 1983

Until Mr. Volcker appears before Congress and presents the Federal Reserve's 1983 objectives for money and credit, financial market participants will have a difficult time divining Fed policy. Since the Fed has put aside M1 as a short-run intermediate target (or indicator), it is not clear how the Fed's week to week policy is being set. (Recall that M1 has been downgraded because of distortions stemming from the newly authorized bank accounts, maturing All Savers Certificates, and strong liquidity demands by the public.) Therefore, it has been impossible to know how the Fed has been determining the proper level of reserves to supply to the banking system. So far, the Fed has accommodated the above-target growth of M1 by readily providing reserves to support its growth. When will the honeymoon be over?

The February meeting with Congress will supply the answer. At that time, the Fed probably will adopt a more deterministic operating procedure. The Fed has been urged to target credit or real interest rates rather than monetary aggregates. Indeed, the Fed itself has conducted studies of the feasibility and desirability of such changes. These approaches have benefits but are not without their drawbacks, and the Fed is more likely to consider a modification in its current methods. Problems in money-aggregates targeting are well known and their nature well understood. A totally new policy approach would inject considerable uncertainty into already difficult times. As a result, it is far more likely that the Fed will either offer new targets for 1983, built on a monetary foundation bloated by deposit shifts into the newly authorized bank accounts, or will once again try a shift-adjusted monetary aggregate. Past experience with shift adjustment has not been good; thus the Fed would be reluctant to try it again. However, the new Money Market Deposit Accounts (MMDAs) have been around since early December, long enough to provide data on the already large shift. Super NOW accounts are a more difficult problem, coming into existence a month later. But these new accounts are not the core of the Fed's problems.

M1 had been growing at above-target rates before the new bank accounts were offered. If that excessive growth stemmed from All Savers money, parked there temporarily, why hasn't it moved out yet? The banks' MMDA accounts, contained in M2, already have attracted $147 billion. Thus the real problem is the excessive growth in M1 and does not seem due to the new bank accounts. So far, Mr. Volcker has been able to put this aside: the income velocity of M1 has shifted. This means people have been holding more money relative to income, and the excessive monetary growth has not been inflationary. But over the rest of the year will velocity growth snap back? Will the Fed be forced to resist a resurgent money supply later in 1983 to ward off inflation? A velocity snapback is what monetarists fear. We will hear something of what the Fed will do when Mr. Volcker addresses Congress, sometime before February 20. Until then, there is a clear and present need for lower interest rates. Yet how long can the money supply be allowed to grow so fast without igniting fears of inflation? This is Mr. Volcker's policy dilemma.

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Market Yields

	1/28/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	15.75%
Effective since	1/11/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.25	8.13	14.00
Repurchase Agreements	8.25	8.13	13.25
U.S. Treasury Issues			
Bills			
3 months	8.31	8.16	13.00
6 months	8.55	8.49	13.69
1 year	8.87	8.78	14.02
Coupons			
2 years	9.48	9.36	14.22
4 years	10.02	9.93	14.20
7 years	10.59	10.47	14.22
10 years	10.66	10.51	14.14
Long Bond	10.82	10.74	13.90
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.30	8.10	13.70
3 months	8.50	8.30	13.95
6 months	8.80	8.55	14.30
1 year	9.00	8.85	14.70
Banker's Acceptances			
1 month	8.35	8.05	13.50
3 months	8.50	8.05	13.95
6 months	8.85	8.10	14.35
Eurodollar Deposits			
1 month	9.00	8.88	14.13
2 months	9.13	9.00	14.50
3 months	9.25	9.00	14.50
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.25	7.00	13.25
1 month	8.25	7.63	13.50
3 months	8.25	7.75	13.50
Bank Holding Companies			
1 month	8.00	7.13	13.13
Dealer Placed:			
3 months	8.26	7.38	13.65
New AA Corporate Utility Bond	12.65	12.65	16.50
Tax Exempt			
6 month Project Notes	4.50	4.60	7.20
1 year AAA Bond	5.25	5.00	6.80
5 year AAA Bond	6.30	6.10	9.00
20 year AAA Bond	8.80	8.60	11.90

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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